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SUBJECT: UKRAINE'S APPROACH TO INVESTMENT PROMOTION: "WHY DO WE NEED YOU GUYS?"

REFS: A) 2005 KIEV 1828

B) 2005 KIEV 1765

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¶1. (SBU) Summary: Ukraine continues to trail behind most of its neighbors in attracting Foreign Direct Investment (FDI). The GOU was slow to recognize its role in this sphere, although it finally created a lead investment promotion agency, called InvestUkraine, in ¶2005. InvestUkraine, with USAID assistance, has since worked to build up its capabilities. It remains a small agency with little ability to affect government policy, however, and is still far from a model investment promotion agency. Some GOU officials, especially at the local levels, continue to question why they need to encourage foreign investment. While enhanced investment promotion efforts have helped attract more FDI to Ukraine, really significant increases will come only when the GOU tackles the institutional problems that create a poor investment/business climate. End Summary.

Ukraine Slow to Welcome FDI

¶2. (U) Ukraine has consistently trailed behind its Central and Eastern European neighbors in terms of attracting Foreign Direct Investment (FDI). Despite the 2005 sale of the Kryvorizhstal steel mill to international giant Mittal Steel for USD 4.8 billion, the single largest foreign investment in Ukraine to date, FDI levels remain relatively low. The total stock of FDI stood at about USD 24 billion as of July, according to official statistics. According to an early 2007 study by the Vienna Institute for International Economic Studies, FDI per capita was a paltry USD 500, only about 12% of the average figure for the 10 new EU members of Central and Eastern Europe, and about 32% of the figure for Russia.

¶3. (SBU) The GOU was slow in recognizing the government's role in attracting investment, for years doing so only on an ad-hoc basis, with no institution taking the lead. The case of computer giant Dell, which in 2005 considered opening major production facilities in Ukraine (refs A-B), was a low point. Dell reps outlined to the GOU the kind of incentives the company would need to open in Ukraine, yet the GOU failed to respond, or even designate someone to serve as Dell's primary point of contact. Dell decided to open a plant in Poland instead, and so Ukraine missed a golden opportunity.

Investment Promotion Agency Finally Born...

14. (SBU) In August 2005, the GOU established the Ukrainian Center for Foreign Investment Promotion -- recently re-branded as InvestUkraine -- to serve as the country's lead investment promotion agency. InvestUkraine is a quasi-independent agency falling under the State Agency of Ukraine for Investments and Innovations. (Note: The State Agency for Investments and Innovations itself has very limited contact with potential investors. Its primary area of activity appears to be managing a state fund that provides low-interest loans (about USD 30 million worth this year) to select, domestic firms. Many observers in Kyiv also believe that it primarily serves to promote the interests of its politically well-connected director, Viktor Ivchenko, who is reportedly close to President Yushchenko and whose spouse is governor of Kyiv Oblast. End Note.)

15. (U) InvestUkraine has expanded its capabilities over the last two years, in part thanks to training provided by USAID's Local Economic Development Program, creating a corps of English-speaking investment promotion professionals and using the Czech agency CzechInvest as its model. InvestUkraine has developed relationships with key oblast and city officials so that it can point potential investors to the right people in the regions. Graduates from the USAID-sponsored training have themselves formed ProInvest, a nationwide network of investment promotion professionals. Ruslan Fedorov, a bright InvestUkraine Investment Manager, told Econoff on November 8 that he saw a major improvement in the work of local officials that had participated in the training. The State Agency for Investments and Innovations plans to provide InvestUkraine with space at its regional innovation centers, now under development, in order to expand InvestUkraine's regional presence.

...But Still Has a Lot of Growing Up to Do

16. (SBU) InvestUkraine remains a small agency and does not have much influence within the government. Igor Nikolaiko, a long-time

government official, took over as Director of InvestUkraine in May. During a introductory meeting with Econ Counselor, Nikolaiko appeared focused more on obtaining additional resources for his organization -- his priorities are a new building and up to 10 foreign offices -- than on developing the country's investment strategy. Ivchenko has said that he had installed Nikolaiko in order to "bolster the leadership" of the organization. Ivchenko has, on several occasions, publicly criticized InvestUkraine for its lack of effectiveness.

17. (U) Recruiting and keeping capable staff is also difficult. Energetic, business-minded, and English-speaking candidates -- the ideal investment promotion professionals -- can draw much larger salaries in Ukraine's booming private sector, making it hard for InvestUkraine and local state bodies to compete. For example, one promising young InvestUkraine employee recently left the agency after less than a year for Germany-based East West Capital.

18. (SBU) Petr Adamek, a consultant from the Czech Republic-based BermanGroup who has worked closely with the GOU, previously told Econoff that InvestUkraine suffered from a lack of "strategic vision" in terms of how it pursued potential investors, often just sitting back and waiting for official inquiries. USAID's Local Economic Development Program has since helped InvestUkraine to develop an official strategy, although it remains to be seen how well the agency's leadership will implement it. Large portions of InvestUkraine's website remain "Under Construction." Another weakness is that the agency has never been given a clear mandate to take over all investor-related functions, as the government maintains a plethora of bodies -- state agencies, consultative bodies, interagency councils, etc. -- that still interface with potential investors.

Lingering Resistance to Foreign Investment

19. (SBU) Some officials within the GOU and oblast/city governments remain suspicious of foreign investment. During a July training session with a Tyco Electronics representative, an official from the eastern Ukrainian city of Dnipropetrovsk commented, "We've talked a

lot about what information we [city officials] should provide to the investor, but the investor must also show why we need him. The investor should prove that he will bring only the newest technologies." The comment reflected a residual mentality among some Ukrainians that the state needs to defend against certain kinds of foreign investors.

¶10. (SBU) Ukrainian government officials often appear obsessed with promoting high-tech industries in Ukraine, at the expense of all others. For these officials foreign investment is valuable only for its potential to bring "new technologies," never clearly defined, to the country. Many Ukrainians of all stripes are resistant to the idea of Ukraine serving as a source of cheap labor. With an educated workforce, relatively low wages (average monthly wages are currently about USD 240 per month according to official statistics), high unemployment in some regions, and proximity to European markets, Ukraine could be a very attractive destination for foreign manufacturers. As Andres Aslund, the well-respected economist and Eastern Europe political analyst, recently put it, "You really have to try hard to deter foreign investment from Ukraine."

Comment: If You Don't Build It, They Won't Come

¶11. (SBU) What, then, is holding Ukraine back? Foreigners have increased investment in Ukraine, but this has been largely concentrated on discrete sectoral opportunities, like getting into the booming banking sector, oil and gas exploration, or the growing consumer sector (e.g., Pepsi's recent purchase of juice producer Sandora), rather than any overall investment attractiveness of Ukraine. Despite enhanced investment promotion efforts, a cheap, highly educated workforce and a location on the doorstep to Europe, Ukraine's business climate remains lousy. Corrupt courts, a dismally-administered tax system, and over-regulation of business activities are just some of the institutional problems that make operating in Ukraine a daunting task for even the most intrepid foreign businessman. Privatization, a potential catalyst for major foreign investment, has slowed almost to a halt, with the privatizations that have gone forward being conducted under less than fully transparent conditions (septel). Ukraine was ranked 139th out of 178 countries in terms of the ease of doing business in the World Bank's most recent survey, putting it behind countries like Iran and Uzbekistan, and not even close to less-than-model neighbors Russia (106th) and Belarus (110th). Until Ukraine fixes its business climate, foreign companies will remain reluctant to

jump into the country with both feet. End comment.

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